

Message Text

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FM AMCONSUL RIO DE JANEIRO

TO SECSTATE WASHDC 6325

INFO AMEMBASSY BRASILIA

AMCONSUL SAO PAULO

C O N F I D E N T I A L SECTION 1 OF 2 RIO DE JANEIRO 2604

E.O. 11652: GDS

TAGS: ETRD, EFIN, BR

SUBJECT: BRAZILIAN VIEWS ON U.S. TRADE LAW AND THE MTN: A
POSSIBLE SHIFT IN GOB POLICY

1. SUMMARY: UNIVERSITY OF MINNESOTA LAW PROFESSOR ROBERT HUDEC, IN BRAZIL ON A USICA-SPONSORED PROGRAM, SPOKE TO BRAZILIAN ECONOMISTS IN RIO ON THE GATT LEGAL SYSTEM AND RECENT DEVELOPMENTS IN U.S. TRADE LAW. ACCOMPANIED BY CONGEN E/C AND/OR CULTURAL AFFAIRS OFFICERS, HUDEC MET WITH THE CHIEF ECONOMIST OF THE CENTER FOR FOREIGN TRADE STUDIES (CENCEX), ALFONSO PASTORE, AND WITH DIRECTOR OF THE GOB CUSTOMS POLICY COUNCIL (CPA), ANTONIO PASCHOAL COMZO. HUDEC ALSO ADDRESSED A SMALL GROUP OF ECONOMISTS AT A CENCEX-SPONSORED ROUNDTABLE DISCUSSION (INCLUDING REPRESENTATIVES FROM CACEX, PETROBRAS AND INTERBRAS, THE GOB-OWNED TRADING COMPANY) AND SPOKE BEFORE A GROUP OF GRADUATE STUDENTS AT THE GETULIO VARGAS FOUNDATION. AMONG THE SUBJECTS DISCUSSED WERE: THE IMPACT ON BRAZIL OF RECENT CHANGES IN U.S. TRADE LAW, BRAZILIAN AND U.S. ROLES IN THE MTN NEGOTIATIONS, AND POSSIBLE NEW DIRECTIONS FOR GOB TRADE AND EXCHANGE RATE POLICY. END SUMMARY.

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2. HUDEC'S COMMENTS ON U.S. TRADE LAW GENERATED THE LARGEST AMOUNT OF INTEREST FROM BRAZILIAN ECONOMISTS, WITH THE SUBSIDY/COUNTERVAILING ISSUE TAKING FIRST PRIORITY. HUDEC NOTED THAT U.S. MANUFACTURERS (AND THEIR LAW FIRMS) WERE BECOMING MORE FAMILIAR WITH THE POTENTIAL OF U.S. TRADE LAW (I.E. SUBSIDY/COUNTERVAILING, ANTI-DUMPING AND ESCAPE CLAUSE PROVISIONS)

FOR GAINING PROTECTION FROM COMPETING IMPORTS. WHEN ASKED IF THE RECENT DECLINE IN THE U.S. EXCHANGE RATE MIGHT EASE PROTECTIONIST SENTIMENT IN THE U.S. AND REDUCE THE NUMBER OF CASES FILED AGAINST IMPORTED GOODS, HUDEC SAID THAT BOTH THE NUMBER OF CASES AND THEIR LEGAL COSTS COULD CONSTITUTE A SERIOUS TRADE BARRIER, PARTICULARLY FOR SMALLER FIRMS IN EMERGENT MARKETS SUCH AS BRAZIL. THIS POINT WAS MADE IN CONNECTION WITH A CACEX REPRESENTATIVE'S QUESTION ON THE EFFECT OF THE U.S. APPLYING THE STEEL TRIGGER PRICE MECHANISM TO BRAZILIAN EXPORTS. IN THIS CASE, HUDEC FELT THAT NO DUTIES WOULD BE LEVIED ON BRAZILIAN STEEL IMPORTS TO THE U.S. BECAUSE NO INJURY COULD BE FOUND. HOWEVER, THE LEGAL COSTS BORN BY BRAZILIAN STEEL EXPORTERS DURING THE INVESTIGATIONS COULD REPRESENT A SERIOUS BARRIER TO TRADE.

3. CENCEX CHIEF ECONOMIST PASTORE CRITICIZED THE TREATMENT OF BRAZILIAN EXPORT SUBSIDIES UNDER U.S. TRADE LAW. IN HIS VIEW, U.S. TRADE LAW TREATS SUBSIDIES AS A MARKET DISTORTION WHICH IMPEDES FREE TRADE. HOWEVER, THE FAULT IN U.S. TRADE LAW, ACCORDING TO PASTORE, IS ITS ASSUMPTION THAT MARKETS HAVE NO OTHER DISTORTIONS PRIOR TO THE APPLICATION OF SUBSIDIES. PASTORE NOTED THAT THIS IS NOT TRUE IN THE CASE OF BRAZIL, WHERE THE EXISTENCE OF HIGH IMPORT DUTIES HAD ALREADY IMPOSED SERIOUS MARKET DISTORTIONS. GIVEN THE POLITICAL PROBLEMS OF REMOVING THESE TARIFFS, PASTORE ARGUES THAT BRAZILIAN EXPORT SUBSIDIES HAVE SERVED AS A "SECOND BEST" SOLUTION WHICH ACTUALLY

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PROMOTE FREER TRADE BY INCREASING BOTH BRAZILIAN EXPORTS AND IMPORTS OF INTERMEDIATE INPUTS REQUIRED FOR EXPORT PRODUCTS.

4. IN DISCUSSIONS ON THE GATT LEGAL FRAMEWORK AND THE CURRENT STATUS OF MTN NEGOTIATIONS, THE EMPHASIS REMAINED ON THE SUBSIDY ISSUE. BOTH LASTORE AND CPA DIRECTOR PASCHOAL NOTED THAT A GATT SUBSIDY CODE WOULD BE OF MAJOR IMPORTANCE TO BRAZIL, STRESSING THE NEED TO INCLUDE AN INJURY CLAUSE IN SUBSIDY/COUNTERVAILING DUTY CASES. PASCHOAL ALSO EMPHASIZED THE GOB DESIRE TO PARTICIPATE FULLY IN MTN TARIFF NEGOTIATIONS, BUT STATED REPEATEDLY THAT GOB OFFERS FOR TARIFF REDUCTIONS WOULD BE EXTREMELY DIFFICULT IN VIEW OF BRAZIL'S CURRENT BALANCE OF PAYMENTS SITUATION.

5. IN DISCUSSING THE BRAZILIAN POSITION IN THE MTN, PASTORE COMMENTED THAT BRAZIL COULD ACHIEVE MUCH GREATER SUCCESS IN THE NEGOTIATIONS AND ALSO REDUCE ITS PROBLEMS VIS-A-VIS U.S. TRADE LAWS BY ADOPTING A NEW TRADE POLICY. PASTORE FEELS THAT BRAZIL SHOULD REMOVE BOTH ITS EXPORT SUBSIDIES AND IMPORT RESTRICTIONS, WHICH SIMULTANEOUSLY UNDERTAKING A MAJOR CRUZEIRO DEVALUATION. WHILE ACKNOWLEDGING THE PROBLEMS THIS PLAN ENTAILS (E.G. THE MONETARY IMPACT OF RELEASING FUNDS HELD UNDER THE

PRIOR IMPORT DEPOSIT REQUIREMENT AND THE INCREASED CRUZEIRO COSTS OF FOREIGN LOANS GENERATED BY DEVALUATION), PASTORE BELIEVES THAT THIS POLICY IS "INEVITABLE." ALTHOUGH PASTORE CONCEDES THAT THE POLITICAL CONSTRAINTS WILL NOT ALLOW THE PRESENT ADMINISTRATION TO IMPLEMENT THIS SCHEME IN TIME FOR IT TO STRENGTHEN THE BRAZILIAN BARGAINING POSITION AT THE MTN, PASTORE FEELS THAT IT WILL BE THE FIRST MAJOR ECONOMIC MOVE OF THE NEW ADMINISTRATION UPON TAKING OFFICE NEXT YEAR.

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6. COMMENT: ALTHOUGH THE POLICY OPTION OF REMOVING EXPORT SUBSIDIES AND IMPORT RESTRICTIONS WHILE UNDERTAKING A MAJOR CRUZEIRO DEVALUATION HAS BEEN UNDER DISCUSSION IN ACADEMIC CIRCLES FOR SOME TIME, PASTORE (A MAN WITH CLOSE GOVERNMENT TIES) NOW INDICATES A GROWING ACCEPTANCE OF THE PLAN WITHIN THE GOB. THIS WAS CORROBORATED BY CPA DIRECTOR PASCHOAL. WHEN CONGEN E/C OFFICER QUERIED HIM ON THE POSSIBILITY OF IMPLEMENTING SUCH A POLICY, PASCHOAL REFRAINED FROM EXPRESSING A PERSONAL OPINION, BUT CONCEDED THAT SUCH A POLICY WAS BEING ANALYZED BY THE FINANCE MINISTRY AND THE CENTRAL BANK. CLEARLY, THE STRONGEST OPPONENTS TO GOB IMPLEMENTATION OF THIS POLICY WOULD BE BRAZILIAN INDUSTRIALISTS WHO BELIEVE THAT EXPORT SUBSIDIES ARE STILL NECESSARY TO ASSURE THEIR COMPETITIVE POSITION IN WORLD MARKETS, AND WHO ALSO HAVE AMASSED SIZEABLE FOREIGN DEBTS WHICH WOULD BE INCREASED BY A CRUZEIRO DEVALUATION. NONETHELESS, PASTORE STATED THAT A FEW MAJOR INDUSTRIALISTS (INCLUDING THE INFLUENTIAL VILLARES GROUP) ARE COMING TO ACCEPT THE NEED TO REMOVE EXPORT SUBSIDIES -- AN ACCEPTANCE CAUSED TO A LARGE

EXTENT BY U.S. TRADE LAW. PASTORE ALSO FELT THAT INCREASED CRUZEIRO COSTS OF FOREIGN DEBT WOULD BE ASSUMED BY THE CENTRAL BANK (AS WAS DONE IN THE CASE OF A RECENT FOREIGN LOAN CON-
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TRACTED BY THE BNDE -- (SEE RIO A-40 OF 6/6).

7. IN LUNCHEON CONVERSATION WITH CONGEN E/C OFFICERS, BRAZILIAN ECONOMIST CARLOS LEMGRUBER ALSO PREDICTED A MAXI-DEVALUATION OF THE CRUZEIRO COUPLED WITH REMOVAL OF EXPORT SUBSIDIES AND IMPORT RESTRICTIONS. LEMGRUBER, EDITOR OF "CONJUNTURA ECONOMICA" - THE HIGHLY RESPECTED ECONOMIC REVIEW PUBLISHED BY THE GETULIO VARGAS FOUNDATION - FELT THAT THE MZXI-DEVALUATION WAS "INEVITABLE" AND WOULD OCCUR SOMETIME WITHIN THE NEXT EIGHTEEN MONTHS. HIS PREDICTION CALLED FOR A ONE TIME 40 PERCENT DEVALUATION OF THE CRUZEIRO WHICH, WHEN COUPLED WITH THE REMOVAL OF EXPORT SUBSIDIES AND IMPORT RESTRICTIONS, WOULD RESULT IN A NET DEVALUATION OF 20 PERCENT. WHILE AWARE OF THE POLITICAL IMPEDIMENTS TO THIS MOVE, LEMGRUBER -- WHO HAS GOOD CONTACTS WITHIN THE GOB -- FEELS THE IMPACT OF THE DROUGHT UPON BRAZILIAN ECONOMIC PERFORMANCE IN 1978 AND ITS RESIDUAL EFFECTS IN 1979 WILL ADD TO ALREADY COMPELLING PRESSURES FOR THE GOB TO UNDERTAKE THIS POLICY SHIFT.
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